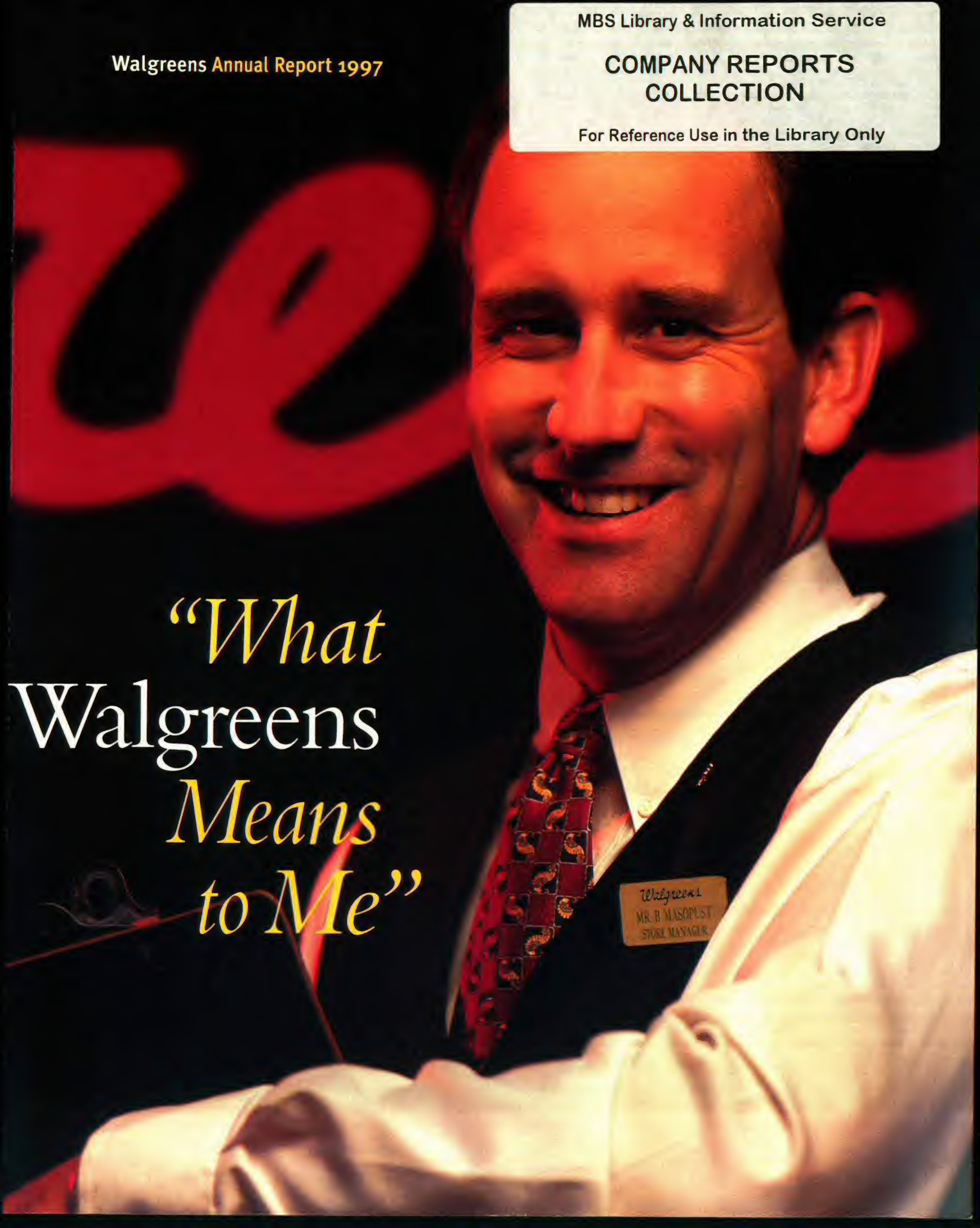
Walgreens Annual Report 1997



"What Walgreens Means to Me"

Walgreen Co.

Walgreens, one of the fastest growing retailers in the United States, leads the chain drugstore industry in sales and profits. Our strategy is to be the nation's most convenient – and most technologically advanced – healthcare retailer. Sales for 1997 reached $13.4 billion, produced by 2,358 stores in 34 states and Puerto Rico. Founded in 1901, Walgreens today has 85,000 employees and 43,000 shareholders of record. Our drugstores serve 2.4 million customers daily and average $5.5 million in annual sales per unit. That's $542 per square foot, among the highest in the industry. Walgreens is guided by a conservative fiscal policy and dedicated to aggressive growth. We've paid dividends in every quarter since 1933 and have raised them in each of the past 21 years.

About the Cover

"When I was in college in 1980, Walgreens was just a job. Today? It's my career…my family's financial security… my retirement…and the new store I'll open just before Christmas."

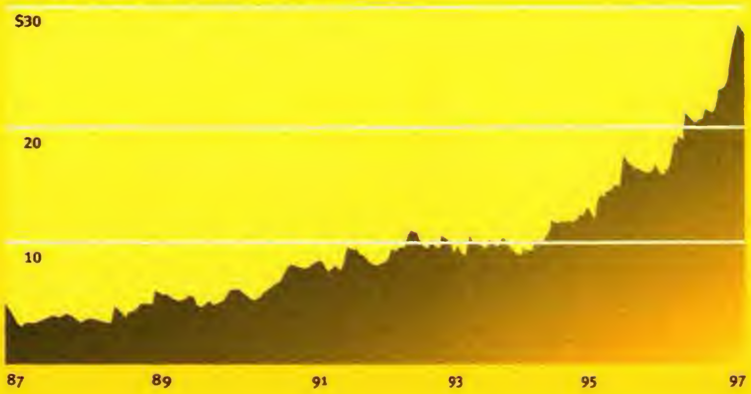
Brad Masopust, store manager in Villa Park, Illinois, has worked for Walgreens for 17 years. Now 37, he's participated in an explosive growth period during which market coverage in the Chicago area alone has tripled to 300 stores. Like most managers, Brad belongs to Walgreens profit sharing plan and owns company stock, both through an employee purchase plan and a unique stock option benefit called *Share Walgreens.*

Financial Highlights

Per share data have been adjusted for a two-for-one stock split distributed to shareholders August 8, 1997.

For the Years Ended August 31, 1997 and 1996 (Dollars in Millions, except per share data)	1997	1996	Increase
Net Sales	$13,363	$11,778	13.5%
Earnings Before Income Tax Provision	712	607	17.3%
Income Tax Provision	276	235	
Net Earnings	$ 436	$ 372	17.2%
Net Earnings per Common Share	$ .88	$ .75	17.3%
Shareholders' Equity	$ 2,373	$ 2,043	16.2%
Return on Average Shareholders' Equity	19.8%	19.4%	
Closing Stock Price per Common Share	$ 26 15/16	$ 16 7/16	
Total Market Value of Common Stock	$13,301	$ 8,092	64.4%

Stock Price Fiscal 1987 – 1997 *Per Quarter*



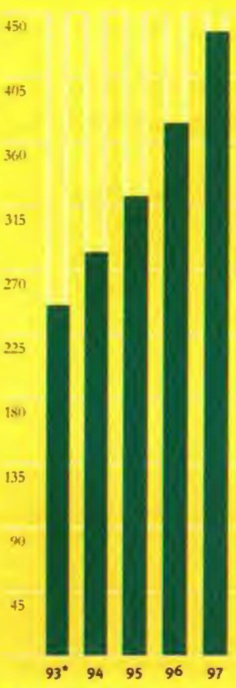
10-Year Walgreen Stock Performance

On August 31, 1987, 100 shares of Walgreen stock sold for $4,162. Ten years later, on August 31, 1997, those 100 shares, having split three times, were 800 shares worth $21,550, for a gain of 418%.

1997 Highlights

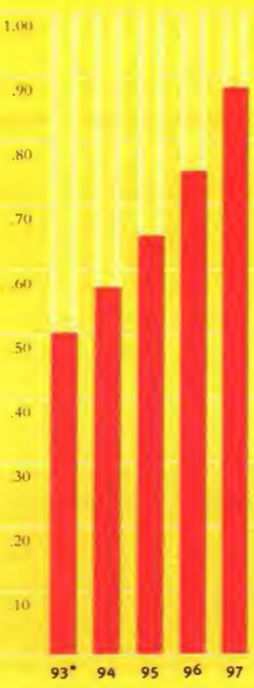
- Walgreens opened a record 251 stores in 1997, 71 of which were relocations to more convenient sites. Well over half the chain — approximately 1,400 stores — is now freestanding. The average age of a Walgreen store today is 7.3 years. By our 100th anniversary in 2001, that number will fall to 5.7 years.
- Walgreens filled 205 million prescriptions last year — nearly 9% of the U.S. retail market and more than any American retailer.
- Drive-thru prescription service is now offered in 900 Walgreen pharmacies and one-hour photo departments are chainwide.
- *WHP Health Initiatives,* Walgreens managed care division, increased sales 38%, to $457 million, in fiscal 1997, while profits doubled. Its two mail service facilities dispensed 4.7 million prescriptions — more than 15,000 per day.
- *What our stock is worth:* Walgreens market capitalization grew $5 billion — to more than $13 billion — just in the past year. Among U.S. retailers in the S&P 500, we had the fifth highest market capitalization as of August 31, 1997, topped only by Wal-Mart, Sears, J.C. Penney and Home Depot.
- Walgreens ranks 25th in the 1997 edition of *The 100 Best Stocks to Own in America,* by Gene Walden.
- *Consistency counts.* Walgreens is one of only 67 companies included on the "Earnings and Dividend Champions" list in Bill Staton's 1997 edition of *America's Finest Companies*. These companies have recorded at least 10 straight years of higher earnings and dividends and are in the top three-tenths of one percent of all publicly-traded companies.
- For the fourth consecutive year, Walgreens was included on *Fortune* magazine's "Most Admired Corporations in America" list. Among food and drug store companies, we ranked *first* in our "ability to attract, develop and keep talented people."

Earnings
Millions of Dollars

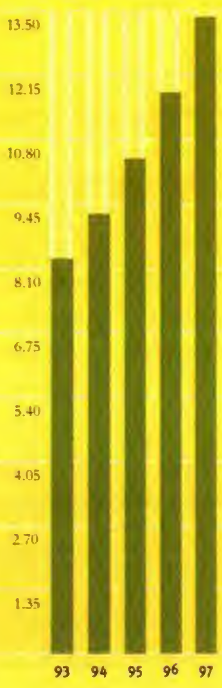


* *Before accounting changes*

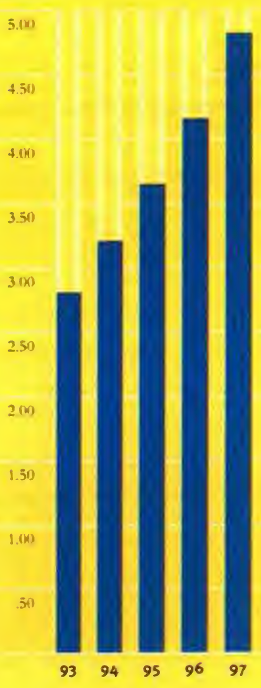
Earnings per Share
Dollars



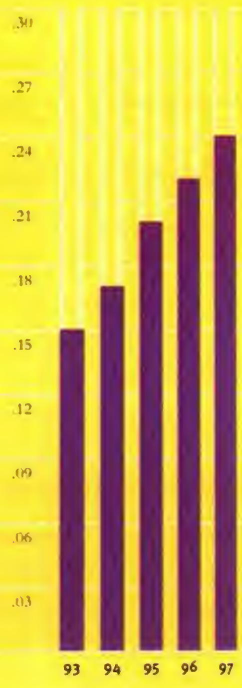
Sales
Billions of Dollars



Shareholders' Equity
Dollars per Share



Dividends Declared
Dollars per Share



L. Daniel Jorndt (left) and
Charles R. Walgreen III
Chicago, Illinois

Letter to Shareholders

November 18, 1997

Welcome to the 1997 Walgreen Co. annual report!

We're delighted to share with you the highlights of another outstanding year for Walgreens — our 23rd consecutive year of record sales and earnings.

Here's a brief sketch of the Walgreen story for fiscal 1997. Our sales rose to $13.4 billion last year — a healthy 13.5% advance — and net earnings increased 17.2% to $436 million or 88 cents per share. Total sales in our comparable stores (those open at least a year) also did well, rising 8.1% for the year.

Our pharmacists — the best in the business, we're convinced — once again maintained Walgreens leadership in pharmacy. These highly professional men and women dispensed over 200 million prescriptions last year — most in the industry — and made possible a healthy 18.1% increase in pharmacy sales.

Prescription sales in our comparable stores were also strong, increasing 13.0% despite another year of low pharmaceutical inflation. Not surprisingly, pharmacy now contributes 47% of total company sales.

By the time you read this letter, our new pharmacy system, *Intercom Plus,* will be up and running in all Walgreen stores across the country. This advanced system — costing over $150 million — raises our service and productivity to a new level. While providing increased patient access to our pharmacists, it also substantially raises the number of prescriptions each store can efficiently dispense.

While all facets of Walgreens performed well last year, we were especially pleased with our many newer stores — those opened within the past two to three years. These include stores in our major new markets for 1996 — Las Vegas, our strongest new market entry *ever* — and Dallas.

Sales in these newer stores—all freestanding—have exceeded our expectations. Walgreens has opened a total of 667 new and relocated stores over the past three years, and over half our stores—approximately 1,400 units—are now freestanding.

One of the most positive facts about Walgreens today is that despite our longevity, *we're getting younger!* The average age of a Walgreen store today is 7.3 years, compared to 14.2 years back in 1986. By our 100th anniversary — 2001 — the average Walgreen store will be only 5.7 years old.

A total of 251 new Walgreen drugstores opened during the year, including 71 stores that were relocated to better, more profitable locations. Our target for fiscal 1998 is 280 new Walgreen drugstores across the country.

We plan to open 360 new stores in fiscal 1999 — that means a new Walgreen drugstore opening somewhere in the U.S. *every day!* By the year 2000, we anticipate operating 3,000 Walgreens across the country. Longer term, we believe there is room for up to *two to three times* this many Walgreen stores in the U.S.

Our next two major markets are Detroit — which opens this fall and can probably support 100 new Walgreens — and Kansas City, where our first stores opened in August.

To help meet our aggressive growth plans and build for the future, the company's capital expenditure budget for fiscal 1998 is targeted at more than $500 million.

As for the future, we sincerely think it can be a very bright one for Walgreens. We say this because of the fundamental strength of the business, and especially because of the energy and optimism we see at every level of our company.

We're also heartened by the increase in prescription usage in the U.S. due to the dramatic aging of our population. Between 1995 and 2005, 55-and-olders in the U.S. will grow at a compound rate of 3.8% — double the rate of the rest of the population. The good news for convenient pharmacies like ours is that these graying Americans take *twice as many* prescriptions per year as the rest of the population.

Managed care providers, serviced through our pharmacy benefits manager, *WHP Health Initiatives,* especially appreciate Walgreens for our excellent store coverage within a market and for our value-added pharmacy services such as speed of delivery, automated phone systems, drive-thrus and patient waiting rooms.

Walgreens balance sheet remains strong and our financial condition excellent. The Board of Directors again voted a moderate dividend increase, which allows us additional cash for our accelerated expansion. The December quarterly dividend will be 6.25 cents per share, an increase of 4.2% to a yearly rate of 25 cents per share.

"The *'Walgreen Streak'* ranks as one of the premier performances in American business today. Only a handful of companies can match it."

— *C.R. Walgreen III*
1997 Store Manager Meeting

Needless to say, 1997 was a strong year for Walgreen Co. and its shareholders. We were pleased to see Walgreens name appear again in Gene Walden's *The 100 Best Stocks to Own in America* (fifth edition), where our ranking improved to 25th.

We sincerely thank our 85,000 employees for all they've done — and continue to do — to make Walgreens the leading drugstore chain in the nation. Our employees *are* Walgreens, and because of them we anticipate another fine year for our company in fiscal 1998.

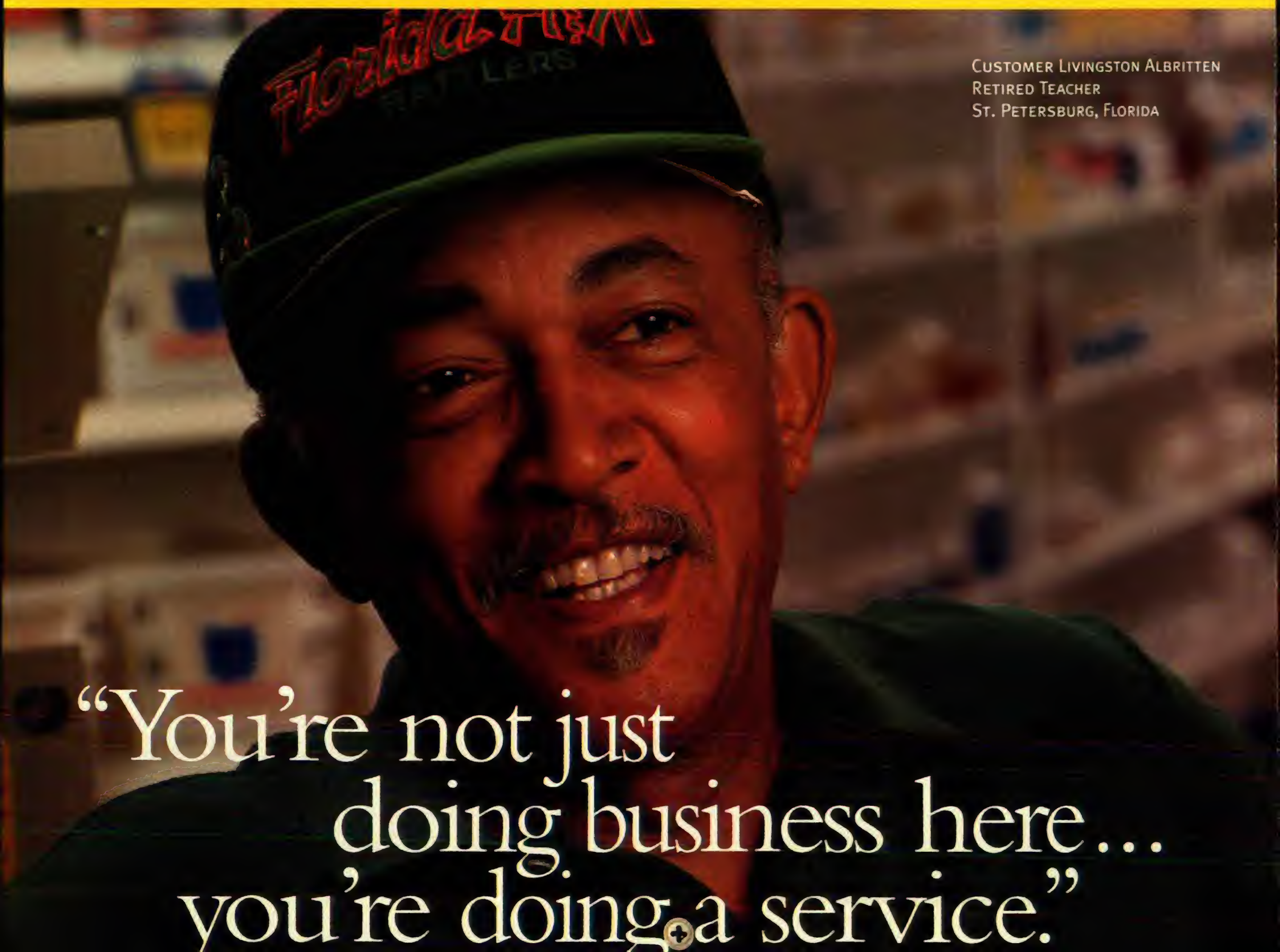
Chairman *President*

Serving the inner city

A year ago street violence battered a St. Petersburg neighborhood which is anchored today by a brand-new freestanding Walgreens. At the time, community members feared we'd abandon plans to build there. But inner city expansion is nothing new for Walgreens. For decades, we've been a fixture in tough parts of cities like Chicago, Houston, Milwaukee, Oakland, Boston and New York. Often we're the convenience store, the grocery store and the drugstore rolled into one in neighborhoods deserted or ignored by most national retailers.

"We do the same things in inner city stores as in the suburbs," says regional vice president Dick Moyer. "Keep shelves well-stocked, have advertised merchandise, provide good customer service and employ local people."

In St. Petersburg, our six-month-old store at 22nd Avenue South & Dr. M.L. King Street is meeting company expectations and sparking neighborhood renewal. A burned-out furniture store across the street is being rebuilt and business at a nearby cafeteria has doubled, according to its owner. "Citizens here feel Walgreens is... '110 percent convenience,'" he says. "Your store has lit up this whole area."



Customer Livingston Albritten
Retired Teacher
St. Petersburg, Florida

Customer Betty Weld
St. Petersburg, Florida

"Transportation is a problem here. Having our own local Walgreens – where we can walk or send our children to shop – is the greatest thing that's happened to this neighborhood."

St. Petersburg City Council Chairman Ernest L. Fillyau, Sr. (right) and former Councilman David T. Welch

"Anyone going in Walgreens direction of investing in inner city neighborhoods has all my support." – *Ernest L. Fillyau, Sr.*

Store Manager Ron Brown
St. Petersburg, Florida

"I grew up in this neighborhood and am so proud to be managing our store here. People like Mr. Albritten make my work a pleasure. He was one of my favorite grade school teachers ... now he's a favorite customer." – *Ron Brown*

Operations Review

"The *Brand* America Trusts" campaign, introduced this fall to promote private label merchandise, is running on local and cable television networks nationwide. Through cable, exposure is now available to 900 stores in markets which previously had no TV advertising.

Walgreens
The Brand America Trusts

"Where else in downtown Denver can you pick up a prescription, drop off a roll of film, buy a can of coffee and leaf through *People* on your lunch hour? Ever since Woolworth abandoned its downtown location, Walgreens has been the only pit stop for basic necessities... And now the store is snazzier than ever."

That was the write-up this summer in Denver's downtown newspaper, which gave their "Best Facelift" award to our 48-year-old store at 801-16th Street following a $1.2 million renovation. But the real news lies in the numbers. Sales volume – in a store which already ranked among the top in the company – has climbed an average of 20% each month since May. And the store's profits matched their record 1996 level, despite the very expensive remodeling *and* the recent opening of a new Payless store across the street.

Downtown Denver – just one more example of the payoff Walgreens receives from a consistent, heavy investment in store renewal.

Walgreens sold nearly 100 million Hallmark greeting cards in 1997. Hallmark, one of our top general merchandise suppliers, values the last-minute convenience our drugstores offer.

Not particularly fancy... but rock solid

Remodel. Relocate. Enter new markets. "Dense up" existing markets. Explore international opportunities. All are critical to Walgreens future as the preeminent, convenience healthcare retailer in its industry.

And despite heavy capital investments for expansion and technology – topping $400 million last fiscal year and $500 million in 1998 – earnings are accelerating and the company remains essentially debt-free.

"We're focused on profitable growth, strong and disciplined operations, and cost-cutting technology," says President Dan Jorndt. "Not particularly fancy strategies... but rock solid.

"Our approach differs from our major competitors," he adds. "Most notably, we are *not* participating in the acquisition feeding frenzy which has gripped our industry. As *Financial World* noted, 'There's as much chance of Walgreen making a major acquisition as there is of Dennis Rodman joining a monastery.' We agree."

Beating the Transformation Curve

The average life of a *Fortune 500* company is 40 years. Walgreens has beaten that curve twice in its 96-year history... while remaining in essentially the same business: neighborhood drugstores.

But take a look at those drugstores!

From freestanding locations to drive-thru pharmacies to one-hour photo departments, Walgreens has set the 1990s trend line which others are emulating. Approximately 1,400 stores are now freestanding... 900 have drive-thrus... and one-hour photo is now chainwide.

These numbers will continue to accelerate as we add or relocate approximately 1,000 units over the next three years, bringing the net total to 3,000 drugstores by the year 2000.

Walgreens operates nearly 450 24-hour stores — the most of any drugstore chain in the U.S. — including this brand-new one in Las Vegas.

Another example? Food departments. This year, a major grocery chain cited drugstores as a reason behind disappointing sales gains: "Fill-in shopping needs," said the grocery CEO, "are increasingly being satisfied in convenience and drug stores." Walgreens, with highly convenient, on-the-way-home locations, is on the receiving end of this trend. "Milk and bread are among the drumbeats of our business," emphasizes Dan Jorndt. "They forge that all-important path between home and store."

This is a mature company, nearly a century old ... with the energy and youthful appearance of a first-grader: The *average* age of a Walgreen store fell to 7.3 years during 1997 and will be just 5.7 years by the end of the century.

We're beating the "transformation curve" by staying *with* the customer and *ahead* of the competitor ... by constantly adapting, innovating and accelerating. As one retailer puts it, if you're concentrating on your rearview mirror, you're likely to crash head-on.

Hot Button #1: Time!

Patience is not a "biggie" on America's list of virtues. Whether it's hamburgers, banking or a carwash, we want it fast, we want it easy and we want it to be high quality. "Saving people time," says the magazine *American Demographics*, "means more than just putting cheese in an aerosol can."

Every corner of Walgreens strategy is focused on convenience: how fast people get into the store – or served in the drive-thru pharmacy ... how fast they get out ... how easily they find what they came to buy ... how well we remind them of what they're *forgetting* to buy.

Nearly 450 24-hour stores, touch-tone prescription refills, flu shots and childhood immunizations, osteoporosis screening, 700 ATM cash machines, phone cards, clerk-served cosmetics and photo departments, rebate booklets, week-long ad prices ... all are designed to give customers back that most precious commodity: *time*.

How 'close' can we grow?

How "glued" is Walgreens to convenient locations?

Within a one-mile radius in downtown *San Francisco*, we operate five stores – representing $40 million in annual sales volume. Four additional stores will open in that same densely-populated area over the next two years.

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"Will it make shopping more convenient?" "Will it make employees' jobs easier?" "Will it reduce operating expenses?" Those are questions probed by systems development staff at Walgreens corporate headquarters. The company has been a leading retail user of technology since the early '80s.

CUSTOMER LENORE IVERSON
AND SON, NICHOLAS
LAS VEGAS, NEVADA

Moving into Las Vegas

"The best thing about a new market is we start with an entirely clean slate," says one store manager. "Every store is sparkling, every manager is hand-picked. We can build the image we want ... and what we want is *terrific* customer service."

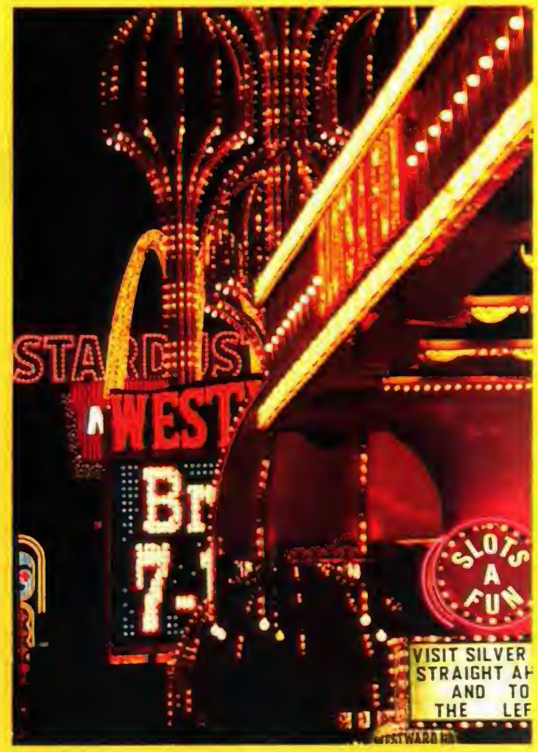
That's certainly worked in Las Vegas, the 15th market Walgreens has entered since 1992 ... *and* the most successful. "Business took off from the get-go," says district manager Greg Wasson. "We opened our first store in August 1996 and of the dozen operating now, several have already posted profitable months. The package Walgreens offers – freestanding stores with drive-thru pharmacies – is totally unique to this market."

Other keys to success? "Solid Walgreen name recognition among customers who've moved here from places like the Midwest and northern California ... participation in all but one major third party prescription plan ... and absolutely awesome locations," says Wasson. "The best part is the seven stores coming next year. They're on sites as good as – if not better than – what's open now."

"Many Las Vegas customers know us from other markets and they're remembering what it's like to be a Walgreen shopper. They know what our stores are about...they trust the Walgreen brands...they expect a lot of service and we give it." – *District Manager Greg Wasson*

TEENAGE CUSTOMERS
ONE-HOUR PHOTO DEPARTMENT
LAS VEGAS, NEVADA

Walgreens second store on the Las Vegas "Strip" will open late next year... sales volume is expected to be triple that of a typical Walgreens.



STORE MANAGER ROB SAUNDERS
GREEN VALLEY STORE, LAS VEGAS

"In 10 years, I've managed Walgreen stores in California, Boston and, now, Las Vegas. Never have I seen business take off so well as here... we've already surpassed our third year estimate." – Rob Saunders

Operations Review

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Near *Houston,* we've relocated a very profitable store *twice in two years* within a one-block area to take advantage of the very best corner. Sales have more than doubled.

In *Las Vegas,* our most successful new market ever, we've approved a second store on the "Strip" which should generate *triple* the volume of our typical store.

A strong balance sheet allows Walgreens to afford the best sites, absorb the early losses associated with new market entries and constantly renew its existing store base through expansion, relocation and remodeling. While most stores are leased, we purchased approximately 90 prime sites last year and are planning to do the same in 1998.

We see excellent opportunities to fill in existing markets across the country, especially as managed healthcare's low pharmacy reimbursement rates force smaller drugstores to close at the rate of six per day.

Walgreens relocated 71 stores in 1997 and 85 are scheduled for 1998. On average, sales volume rises 30% – and customer count, 10% – the first year a store is relocated. By the second year, profits accelerate significantly.

New markets continue to open rapidly. This year's list includes Kansas City, where our first four stores opened in August; Detroit, opening this fall; Charlotte, North Carolina; Birmingham, Alabama; Dayton, Ohio; Norfolk, Virginia; Lafayette, Louisiana; and Jackson, Mississippi.

Walgreens will add approximately 1,000 stores over the next three years, bringing the net total to 3,000 drugstores by the year 2000. The average age of a Walgreens fell to 7.3 years in 1997 and will be just 5.7 years by the end of the century.

Mail service facilities in Tempe, Arizona, and Orlando, Florida, dispense more than 15,000 prescriptions a day. The Tempe center will be expanded a year ahead of schedule due to higher-than-projected sales to managed healthcare plans.

Excellent opportunities also exist in communities with the population to support only a few stores. Towns such as Cedar Rapids, Iowa... Cleveland, Tennessee... and Thibodaux, Louisiana, welcomed Walgreens in 1997.

We are rapidly expanding our 'pharmacy-only' stores in Southern California. By 2000, we'll operate more than 100 of these highly-convenient 2,000-square-foot units in Orange, Los Angeles, Riverside and San Bernardino counties.

Additional full-sized store markets will be announced in 1998 and a formal study of international expansion is under way, with stores projected to open outside the U.S. within five to six years.

It's not where we *are* ... it's where we *aren't*

"We tend to look at a map and see where we *aren't* rather than where we are," says Chairman Charles R. Walgreen III. "Even as the most 'national' of drug chains, there are so many people we're not serving."

New market expansion takes fortitude. We're not afraid to take on a highly competitive market... and we'll stay with it when the going is tough. While Las Vegas and Dallas achieved early success, with many stores making money in their first year, others – such as Indianapolis, California's Central Valley and Cleveland – have turned the corner to profitability only after four or more years.

The good news is they *do* turn that corner as more stores open, fixed costs are covered and the Walgreen name grows familiar to area shoppers. The *better* news is that experience is proving its worth in new market expansion. The "newest of the new" are turning profitable earlier. In 1997, stores open two to three years – as a group – made money despite heavy costs associated with the greatest expansion in our history.

Funny, we don't *feel* old

They still flock to Rolling Stones concerts and they still wear their jeans... but they're turning 50-year birthday parties into a full-time business opportunity and AARP membership mailings into some of the post office's heaviest traffic.

The baby boom generation born between 1946 and 1964 is hitting middle age in full stride. Twice as many Americans were born in 1955 as in 1935. Between now and the year 2030, the proportion of people over 65 will almost double.

The implications for healthcare – including drugstores – are dramatic. Today the average number of prescriptions filled in a Walgreen pharmacy is approximately 250 per day, highest in the industry. We believe that average will climb to more than 400 per day, propelled by graying Americans who take twice as many prescriptions per year as the rest of the population.

But as prescription sales *rise*, managed healthcare continues to drive profit margins *down*. More than 75% of Walgreen prescriptions are now paid by a third party versus cash at the pharmacy counter. Despite the refusal of Walgreens and other major drugstore retailers to accept plans with unprofitable reimbursement levels, third party margins continue to be pressured. At Walgreens, improved operations in the rest of the store help offset the decline.

Driving down costs

The long-term solutions to profit margin pressure are driving sales *up* and costs *down*. Sales in comparable stores (open more than a year) rose more than 8% in 1997 and we again lowered expenses, from 22.6% of sales to 22.2%. This number has fallen more than a full percentage point since 1992 due to efficient store and distribution technology, lower advertising costs and tight expense control at store level. It will continue to decline as new systems pay off.

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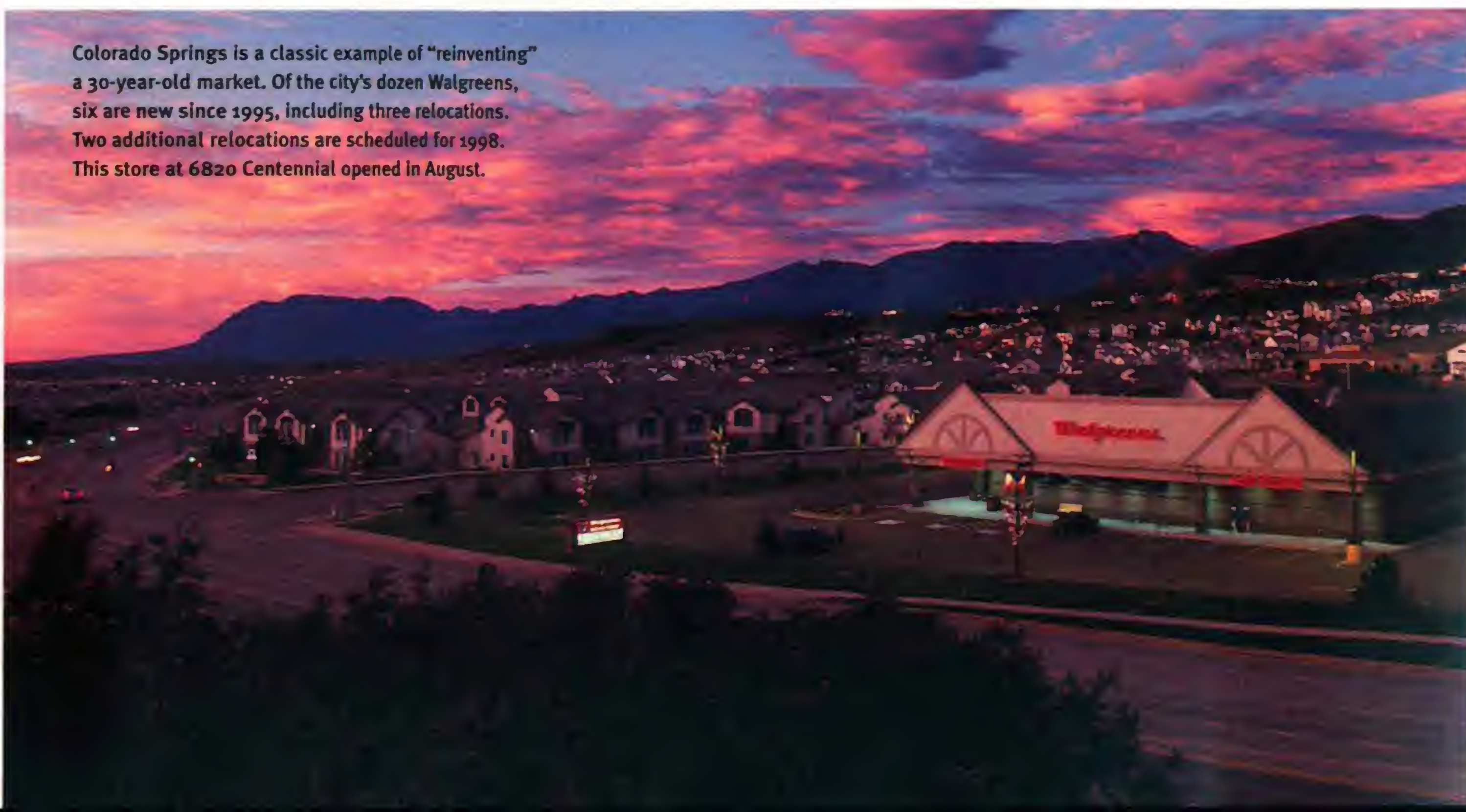


Colorado Springs is a classic example of "reinventing" a 30-year-old market. Of the city's dozen Walgreens, six are new since 1995, including three relocations. Two additional relocations are scheduled for 1998. This store at 6820 Centennial opened in August.

"Two years ago I had a 5th grade student who'd received D's in spelling and writing. Over the course of three quarters, his grades came up to B's. The day he brought in his first 100% spelling test was unforgettable."

– *Bob Kahng*

Bob Kahng, Walgreen Finance Manager and "One-on-One" tutor
With student Carlos Villela
Chicago, Illinois

Program Director John Riccobono and students
Walgreen-funded "One-on-One" tutoring program
Boston, Massachusetts

"As we expand in our nation's inner city neighborhoods, we want to be more than a place to shop and work. Through tutoring programs like 'One-on-One,' we're partners in these kids' futures."

– *Walgreen President Dan Jorndt*

Helping kids one on one

A tutoring program sponsored by Walgreens for inner city children was honored in April as one of 50 successful "Teaching Examples" at the *President's Summit for America's Future* in Philadelphia. Several dozen Walgreen employees have volunteered as tutors for "One-on-One," which the company has funded through Chicago's Midtown Educational Foundation since 1989. We support similar programs in Boston, Milwaukee, St. Louis and San Antonio.

"I've been struck by the condition of inner city neighborhoods since moving to Chicago," says corporate staff member Bob Kahng, a "One-on-One" tutor. "While I can't personally impact inner city dynamics, a program like this makes a tangible difference to one child. Midtown also goes beyond basic tutoring into character development and mentoring. Their methods work... that's why I volunteer there."

MRS. MARTHA VILLELA
MOTHER OF "ONE-ON-ONE" STUDENT
CHICAGO, ILLINOIS

Operations Review

(continued from page 11)

Chief among these is *Intercom Plus,* Walgreens proprietary, second generation pharmacy system, developed at a cost of $150 million. Chainwide this fall, *Intercom Plus* decreases the time and cost spent to fill a prescription and increases patient access to the professional pharmacist. It also supports totally electronic touch-tone phone refills, a service which is faster for the patient and has cut the pharmacy phone load almost in half in markets where it's been in place several months.

Integral to *Intercom Plus* is a workflow system which optimizes the role of the pharmacy technician and allows the higher-paid registered pharmacist to concentrate on what he or she was educated to do: counsel patients and verify prescriptions.

The top chain-based PBM in the country

There are two sides to managed care: the pressure it applies to prescription margins... and the opportunities it affords Walgreens pharmacy benefits manager (PBM) – *WHP Health Initiatives.*

WHP – the top chain-based PBM in the country – is projected to be a $1 billion business by 2001. It packages a full complement of services to make it more convenient and economical for managed care groups to serve their members. These include retail and mail service prescriptions, durable medical equipment, home infusion services, long-term pharmacy and Pharmaceutical Care Centers (PCCs). Using the database fed by our on-line pharmacy system, our two PCCs lower prescription costs and often improve care by monitoring patient compliance, disease management and generic or therapeutic drug conversion.

Less inventory = more cash

In 1987, Walgreens launched the development of SIMS, a proprietary inventory system that has turned the way we handle merchandise – from vendor order to store cash register – inside out. Ten years later, our cash flow is $270 million richer. This is money we would have spent on inventory to support sales *without* SIMS. On a relative basis, we estimate SIMS store systems will contribute an additional $1 billion in cash in the next four years.

SIMS also improves in-stock conditions and helps store managers tailor merchandise mix to local neighborhoods. We believe the system will improve our general merchandise sales trend significantly as we strengthen our ability to be in-stock with the right quantities of merchandise in the right stores at the right time.

'Market Basket' power

Half of Walgreens sales represent impulse purchases. Sophisticated 'slicing and dicing' of scanning data provides a significant opportunity to increase items purchased per shopping trip. We are looking not just at individual

Through *WHP Health Initiatives,* Walgreens has been the exclusive retail and mail service prescription provider for the Chicago Transit Authority since 1993. "We look for stability and reputation," says Chuck Andersen, General Manager of Benefit Services for the CTA. "I know Walgreens is going to be around and I know you're always going to try to do the right thing."

More than one-third of the chain – 900 stores – now offers drive-thru prescription service. Walgreens high pharmacy volume and sophisticated technology make this a profitable concept as well as a very convenient 'value-added' for customers.

items purchased, but at the customer's total "market basket" to measure the importance of an entire transaction. Some product relationships are obvious, others are surprises. If a woman buys a swimmer's ear product, will she also pick up sunscreen? Does the thermometer customer usually buy aspirin? The toy buyer a birthday card?

"This type of analysis takes category management to a new level," says executive vice president Vern Brunner. "Ultimately, it will help us better cross-merchandise our stores, making us more convenient and increasing impulse sales."

You could park *six* 747 airliners...

...in most Walgreen distribution centers, and *12* in Windsor, Wisconsin, where a major expansion is doubling our facility to 800,000 square feet. A similar $60 million expansion now under way in Mt. Vernon, Illinois, will be complete by 1999.

We opened our first company-operated distribution facility in Puerto Rico this fall. Nationwide over the next five years, we will add well over one million square feet of warehouse capacity – the equivalent of a new or expanded center every other year – to meet the demand generated by store growth.

Supplying Walgreens broad merchandise mix requires technology which supports frequent replenishment of quantities as small as a few bottles of shampoo or a few packages of over-the-counter allergy medication. In addition to highly automated split-case picking machines, we have installed a proprietary pick-to-light system in our Orlando center. This will be in place in all eight major DCs by 1999.

One customer at a time

As the 21st century begins, Walgreens will be serving *one billion customers a year*... and serving them essentially the way Charles Walgreen Sr. did at the beginning of the 20th century – *one at a time.* Everything a retailer does – from technology development to site selection to inventory management – must support and enhance the ability of one employee to serve one customer... and serve her *very well.*

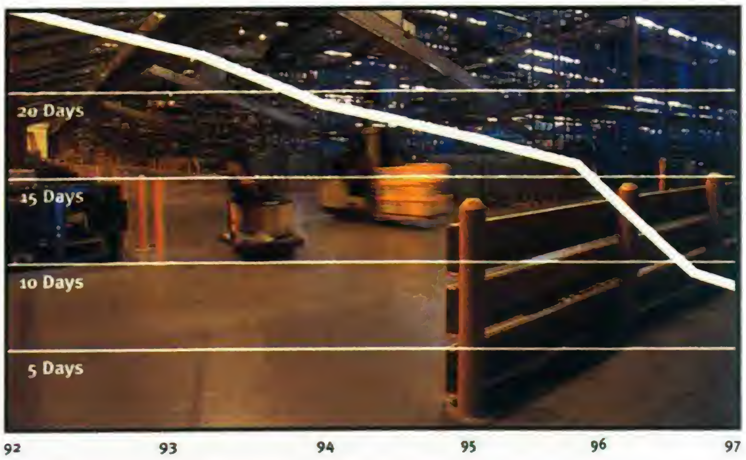
"I've said many times," says retiring Chairman Charles R. Walgreen III, "that my vision isn't to be the largest retailer in the world... but to be the best."

"Being the best" requires meeting the challenge business author Tom Peters recently put to a group of retailers. Innovate, he said... and fight against the "commoditization" which makes it almost impossible for customers to distinguish one store from another.

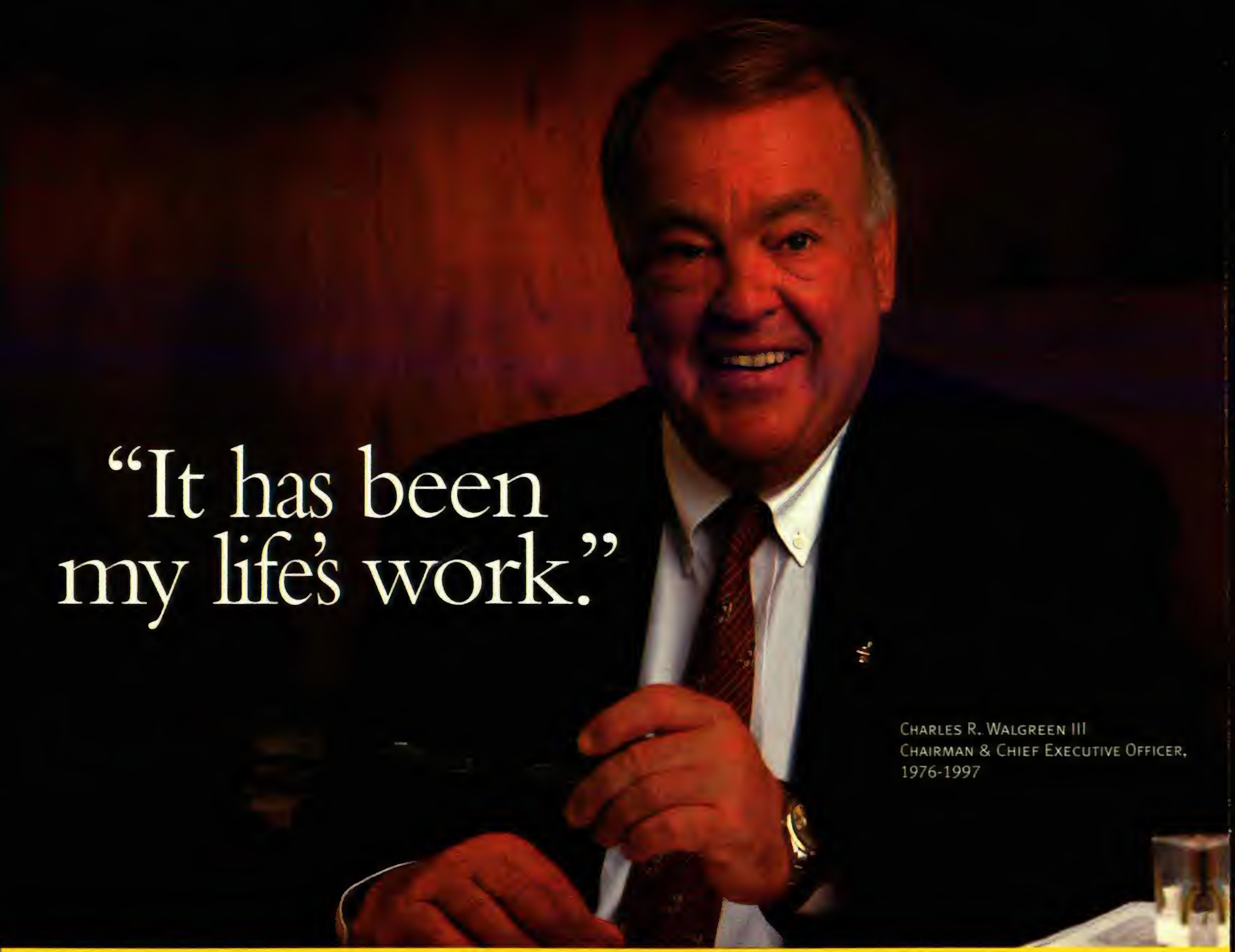
"Because *no one,*" concluded Peters, "wins *anywhere* unless they are pretty special over the long haul."

At Walgreens, we believe in – and build for – the long haul. *Consistently, profitably, one customer at a time.* It's worked for nearly a century. It's the only way we know.

SIMS: Reducing Our Days' Supply ... *$270 Million Savings to Date in Our DCs*



To date, the proprietary *SIMS* system has taken $270 million out of warehouse inventory by reducing "days of supply" of merchandise, thus freeing dollars to finance growth. On a relative basis, *SIMS* is projected to contribute an additional $1 billion to cash flow over the next four years.



CHARLES R. WALGREEN III
CHAIRMAN & CHIEF EXECUTIVE OFFICER,
1976-1997

Charles R. Walgreen III retires

His first job with the company his grandfather founded was in 1952...stocking shelves and sweeping the floors in an Evanston, Illinois, store during high school. Forty-five years later, Charles R. Walgreen III is relinquishing his position as Chief Executive Officer. Under his leadership, the number of drugstores more than quadrupled...annual sales volume catapulted from $800 million to more than $13 billion...and Walgreens earned the Number One ranking in the chain drugstore industry and recognition as one of *Fortune's* "Most Admired Corporations in America."

"As I leave the company in the capable hands of President Dan Jorndt, I've never been more optimistic about our future," says Mr. Walgreen. "The best years in our history are coming up. We're growing faster than even in my grandfather's time...our stores have never been in better shape...nor have they been managed by more qualified men and women.

"What I see in this company in the 1990s is the tremendous spirit of our early days."

"OUR HISTORY SPANS THE ENTIRE 20TH CENTURY… AND GENERATIONS OF EMPLOYEES AND CUSTOMERS. BUT OUR BUSINESS REMAINS ESSENTIALLY THE SAME AS IN 1901: SERVING PEOPLE IN NEIGHBORHOOD DRUG-STORES AS 'THE PHARMACY AMERICA TRUSTS.'"

757 N. MICHIGAN AVENUE
CHICAGO – 1948

641 N. CLARK STREET
CHICAGO – 1997

THREE GENERATIONS OF WALGREENS – C.R. WALGREEN, JR. (LEFT) AND SON, C.R. WALGREEN III, 1959. IN PORTRAIT IS COMPANY FOUNDER C.R. WALGREEN, SR.

"I've never been more optimistic about our company's future than I am today."

– C.R. Walgreen III

"As I end my active career, I'd like to thank the thousands of dedicated, talented people who've meant so much to our company's success… and made my years here so personally rewarding. My grandfather would be so proud of what we've achieved."

CHARLES R. WALGREEN, SR.'S FIRST DRUGSTORE
4134 COTTAGE GROVE AVENUE
CHICAGO – 1901

Eleven-Year Summary of Selected Consolidated Financial Data

Walgreen Co. and Subsidiaries
(Dollars in Millions, except per share data)

	Fiscal Year	1997	1996	1995
Net Sales		$13,363	$11,778	$10,395
Costs and Deductions	Cost of sales	9,682	8,515	7,482
	Selling, occupancy and administration	2,973	2,659	2,393
	Other (income) expense *(1)*	(4)	(3)	(4)
	Total Costs and Deductions	12,651	11,171	9,871
Earnings	Earnings before income tax provision	712	607	524
	Income tax provision	276	235	203
	Net Earnings	$ 436	$ 372	$ 321
Per Common Share *(3)*	Net Earnings *(2)*	$ .88	$ .75	$ .65
	Dividends Declared	.24	.22	.20
	Book Value	4.81	4.15	3.64
Non-Current Liabilities	Long-term debt	$ 3	$ 4	$ 2
	Deferred income taxes	113	145	142
	Other non-current liabilities	279	260	238
Assets and Equity	Total Assets	$ 4,207	$ 3,634	$ 3,253
	Shareholders' Equity	$ 2,373	$ 2,043	$ 1,793
	Return on Average Shareholders' Equity	19.8%	19.4%	19.1%

(1) Fiscal 1993 includes the $7 million costs from the early redemption of the company's $100 million 9 1/2% sinking fund debentures, due 2016. Fiscal 1991 includes a $4 million loss from the closing of the company's Memphis, Tennessee, distribution center. Fiscal 1989 includes a $6 million loss on sale of manufacturing operations.

(2) Fiscal 1993 results of operations exclude the $24 million ($.05 per share) costs from the cumulative effect of accounting changes for postretirement benefits and income taxes.

(3) Per share data have been adjusted for two-for-one stock splits in 1997, 1995 and 1991.

1994	1993(2)	1992	1991	1990	1989	1988	1987
$9,235	$8,295	$7,475	$6,733	$6,047	$5,380	$4,884	$4,282
6,615	5,959	5,378	4,829	4,356	3,849	3,469	3,001
2,165	1,930	1,739	1,583	1,407	1,278	1,190	1,070
(3)	7	5	9	3	9	16	17
8,777	7,896	7,122	6,421	5,766	5,136	4,675	4,088
458	399	353	312	281	244	209	194
176	154	132	117	106	90	80	90
$ 282	$ 245	$ 221	$ 195	$ 175	$ 154	$ 129	$ 104
$ .57	$ .50	$ .45	$ .39	$ .35	$ .31	$ .26	$ .21
.17	.15	.13	.12	.10	.09	.08	.07
3.20	2.80	2.51	2.20	1.92	1.67	1.45	1.26
$ 2	$ 6	$ 19	$ 123	$ 147	$ 150	$ 172	$ 141
138	144	172	155	139	118	106	97
214	176	104	85	77	69	55	51
$2,873	$2,506	$2,347	$2,074	$1,896	$1,666	$1,501	$1,354
$1,574	$1,379	$1,233	$1,081	$ 947	$ 823	$ 713	$ 622
19.1%	18.8%	19.1%	19.2%	19.7%	20.1%	19.3%	17.6%

Results of Operations

Fiscal 1997 was the twenty-third consecutive year of record sales and earnings. Net earnings were $436 million or $.88 per share, an increase of 17.2% from last year's earnings of $372 million or $.75 per share. Earnings increases resulted from higher sales and improved expense ratios.

Total net sales increased by 13.5% to $13.4 billion in fiscal 1997 compared to increases of 13.3% in 1996 and 12.6% in 1995. Drugstore sales increases resulted from sales gains in existing stores and added sales from new stores, each of which include an indeterminate amount of market-driven price changes. Comparable drugstore (those open at least one year) sales were up 8.1% in 1997, 8.5% in 1996, and 7.2% in 1995. New store openings accounted for 8.6% of the sales gains in 1997 and 7.6% in 1996 and 1995. The company operated 2,358 drugstores as of August 31, 1997, compared to 2,193 a year earlier.

Prescription sales increased 18.1% in 1997, 18.0% in 1996, and 19.8% in 1995. Comparable drugstores were up 13.0% in 1997 and 1996, and 13.8% in 1995. Prescription sales were 47.1% of total sales for fiscal 1997 compared to 45.2% in 1996 and 43.4% in 1995. Pharmacy sales trends are expected to continue primarily because of expansion into new markets, increased penetration in existing markets and demographic changes such as the aging population.

Gross margins as a percent of sales decreased to 27.5% of sales from 27.7% last year and 28.0% in fiscal 1995. Prescription margins continue to decrease as third party retail and mail order sales become a larger portion of pharmacy sales. The company is responding to gross margin pressures by emphasizing minimum third party profitability standards. Improved gross margins in the rest of the store helped offset the decline.

The company uses the last-in, first-out (LIFO) method of inventory valuation. The effective LIFO inflation rates were .82% in 1997, .68% in 1996, and 1.29% in 1995, which resulted in charges to cost of sales of $16 million in 1997, $13 million in 1996, and $21 million in 1995. Inflation on prescription inventory was 1.9% in 1997, 2.3% in 1996, and 2.8% in 1995.

Selling, occupancy and administration expenses were 22.2% of sales in fiscal 1997, 22.6% of sales in fiscal 1996, and 23.0% of sales in fiscal 1995. The fiscal 1997 decrease, as a percent to sales, was caused principally by lower advertising expenses. The fiscal 1996 decrease, as a percent to sales, was caused by lower advertising expenses, insurance costs and improved accounts receivable collection experience. The growth in mail order pharmacy, which has a lower expense ratio, has also been contributing to the decreases.

Interest income was relatively constant over the three year periods. Average net investment levels were approximately $79 million in 1997, $76 million in 1996, and $59 million in 1995.

The fiscal 1997, 1996 and 1995 effective tax rates were 38.75%.

Financial Condition

Cash and cash equivalents were $73 million at August 31, 1997, compared to $9 million at August 31, 1996. Short-term investment objectives are to maximize yields while minimizing risk and maintaining liquidity. To attain these objectives, investment limits are placed on the amount, type and issuer of securities.

Net cash provided by operating activities for fiscal 1997 was $650 million compared to $411 million a year ago. The change between periods was principally due to higher earnings and better inventory control which included improved payment terms. Contributing to this improvement was the company's SIMS inventory management system. The company's profitability is the principal source for providing funds for expansion and remodeling programs, dividends to shareholders and funding for various technological improvements.

Net cash used for investing activities was $486 million versus $299 million last year. Additions to property and equipment were $485 million compared to $364 million last year. During the year, 251 new or relocated drugstores were opened which included four acquired locations. This compares to 210 new or relocated drugstores opened in the same period last year. New stores are owned or leased. There were 110 owned locations opened during the year or under construction at August 31, 1997, versus 57 for the same period last year. The company borrowed $19 million in fiscal 1997, compared to $82 million in fiscal 1996, from corporate-owned life insurance policies.

Capital expenditures for fiscal 1998 are expected to exceed $500 million. The company expects to open at least 280 new stores in fiscal 1998 and 360 in fiscal 1999. The company is continuing to relocate stores to more convenient and profitable freestanding locations. Expectations are that 3,000 drugstores will be operating by the year 2000. The company believes that additional expansion across the country is still possible beyond the year 2000. This may necessitate future long-term borrowings. Intercom Plus, an advanced pharmacy computer and workflow system, is expected to be fully implemented in early fiscal 1998.

Net cash used for financing activities was $100 million compared to $125 million a year ago. The company issued 1.5 million shares of authorized but previously unissued shares to satisfy various stock option and purchase plan requirements. This avoided purchasing shares on the open market which would have resulted in cash outflows of approximately $40 million. At August 31, 1997, the company had $139 million in unused bank lines of credit and $100 million of unissued authorized debt securities, previously filed with the Securities and Exchange Commission.

In September 1997, the company concluded a tax case which involved the depreciable lives of certain assets. This resolution resulted in a fiscal 1998 first quarter payment of approximately $37 million of tax. In addition, during the first quarter of fiscal 1998, $58 million of cash was received from the surrender of a group of corporate-owned life insurance policies. As of August 31, 1997, the company adequately provided for the tax and related interest.

The company has been addressing computer software modifications or replacements to enable transactions to process properly in the year 2000. All necessary changes are expected to occur in a timely manner and the cost will not have a significant impact on the ongoing results of operations.

In March 1997, Financial Accounting Board Statement No. 128 "Earnings Per Share" was issued. Under this pronouncement, which must be adopted in our fiscal 1998 second quarter, "basic earnings per share" and "diluted earnings per share," as defined by the bulletin, will replace "primary earnings per share" and "fully diluted earnings per share." The objective is to make the computation more compatible with international accounting standards. The company does not expect basic earnings per share to be materially different from primary earnings per share.

Consolidated Statements of Earnings and Retained Earnings

Walgreen Co. and Subsidiaries
For the Years Ended August 31, 1997, 1996 and 1995
(Dollars in Millions, except per share data)

	Earnings	1997	1996	1995
Net Sales		$13,363	$11,778	$10,395
Costs and Deductions	Cost of sales	9,682	8,515	7,482
	Selling, occupancy and administration	2,973	2,659	2,393
		12,655	11,174	9,875
Other (Income) Expense	Interest income	(6)	(5)	(5)
	Interest expense	2	2	1
		(4)	(3)	(4)
Earnings	Earnings before income tax provision	712	607	524
	Income tax provision	276	235	203
	Net earnings	$ 436	$ 372	$ 321
Net Earnings per Common Share		$ .88	$ .75	$ .65

Retained Earnings	1997	1996	1995
Balance, beginning of year	$ 1,966	$ 1,716	$ 1,497
Net earnings	436	372	321
Cash dividends declared: $.24 per share in 1997, $.22 in 1996 and $.20 in 1995	(118)	(109)	(96)
Employee stock purchase and option plans	(18)	(13)	(6)
Balance, end of year	$ 2,266	$ 1,966	$ 1,716

The accompanying Statement of Major Accounting Policies and the Notes to Consolidated Financial Statements are integral parts of these statements.

Consolidated Balance Sheets

Walgreen Co. and Subsidiaries
At August 31, 1997 and 1996
(Dollars in Millions)

	Assets	1997	1996
Current Assets	Cash and cash equivalents	$ 73	$ 9
	Accounts receivable	376	288
	Inventories	1,733	1,632
	Other current assets	144	90
	Total Current Assets	2,326	2,019
Non-Current Assets	Property and equipment, at cost, less accumulated depreciation and amortization	1,754	1,449
	Other non-current assets	127	166
	Total Assets	$4,207	$3,634

	Liabilities and Shareholders' Equity	1997	1996
Current Liabilities	Trade accounts payable	$ 813	$ 692
	Accrued expenses and other liabilities	554	467
	Income taxes	72	23
	Total Current Liabilities	1,439	1,182
Non-Current Liabilities	Deferred income taxes	113	145
	Other non-current liabilities	282	264
	Total Non-Current Liabilities	395	409
Shareholders' Equity	Preferred stock, $.125 par value; authorized 16 million shares; none issued	–	–
	Common stock, $.15625 par value; authorized 1.6 billion shares; issued and outstanding 493,789,966 in 1997 and 492,282,144 in 1996	77	77
	Paid-in capital	30	–
	Retained earnings	2,266	1,966
	Total Shareholders' Equity	2,373	2,043
	Total Liabilities and Shareholders' Equity	$4,207	$3,634

The accompanying Statement of Major Accounting Policies and the Notes to Consolidated Financial Statements are integral parts of these statements.

Consolidated Statements of Cash Flows

Walgreen Co. and Subsidiaries
For the Years Ended August 31, 1997, 1996 and 1995
(Dollars in Millions)

	Fiscal Year	1997	1996	1995
Cash Flows from Operating Activities	Net earnings	$ 436	$ 372	$ 321
	Adjustments to reconcile net earnings to net cash provided by operating activities –			
	Depreciation and amortization	164	147	132
	Deferred income taxes	8	3	(7)
	Other	8	5	3
	Changes in operating assets and liabilities –			
	Trade accounts payable	121	85	73
	Inventories	(101)	(178)	(191)
	Accounts receivable	(74)	(60)	(36)
	Accrued expenses and other liabilities	73	42	42
	Income taxes	12	(9)	1
	Other	3	4	7
	Net cash provided by operating activities	650	411	345
Cash Flows from Investing Activities	Additions to property and equipment	(485)	(364)	(310)
	Net (investment in) borrowing against corporate-owned life insurance	(16)	47	(34)
	Disposition of property and equipment	15	18	15
	Net proceeds from marketable securities	–	–	30
	Net cash used for investing activities	(486)	(299)	(299)
Cash Flows from Financing Activities	Cash dividends paid	(116)	(105)	(93)
	Cost of employee stock purchase and option plans	(18)	(13)	(6)
	Proceeds from (purchases for) employee stock plans	35	(7)	4
	Payments of long-term obligations	(1)	–	(7)
	Net cash used for financing activities	(100)	(125)	(102)
Changes in Cash and Cash Equivalents	Net increase (decrease) in cash and cash equivalents	64	(13)	(56)
	Cash and cash equivalents at beginning of year	9	22	78
	Cash and cash equivalents at end of year	$ 73	$ 9	$ 22

The accompanying Statement of Major Accounting Policies and the Notes to Consolidated Financial Statements are integral parts of these statements.

Statement of Major Accounting Policies

Description of Business
The company is principally in the retail drugstore business. Stores are located in 34 states and Puerto Rico. At August 31, 1997, there were 2,358 retail drugstores and two mail service facilities. Prescription sales were 47.1% of total sales for fiscal 1997 compared to 45.2% in 1996 and 43.4% in 1995.

Basis of Presentation
The consolidated statements include the accounts of the company and its subsidiaries. All significant intercompany transactions have been eliminated. The financial statements are prepared in accordance with generally accepted accounting principles and include amounts based on management's most prudent judgments and estimates. Actual results may differ from these estimates.

Cash and Cash Equivalents
Cash and cash equivalents include cash on hand and all highly liquid investments with an original maturity of three months or less. The company's cash management policy provides for the bank disbursement accounts to be reimbursed on a daily basis. Checks issued but not presented to the banks for payment of $145 million and $143 million at August 31, 1997 and 1996, respectively, are included in cash and cash equivalents as reductions of other cash balances.

Financial Instruments
The company had approximately $38 million and $12 million of outstanding letters of credit at August 31, 1997 and 1996, respectively, which guaranteed foreign trade purchases. Additional outstanding letters of credit of $59 million at August 31, 1997 and 1996, were related to insurance activities. The company also had purchase commitments of approximately $209 million and $68 million at August 31, 1997 and 1996, respectively, related to the purchase of store locations. There were no investments in derivative financial instruments during fiscal 1997 and 1996.

Inventories
Inventories are valued on a lower of last-in, first-out (LIFO) cost or market basis. At August 31, 1997 and 1996, inventories would have been greater by $444 million and $428 million, respectively, if they had been valued on a lower of first-in, first-out (FIFO) cost or market basis. Cost of sales is primarily computed on an estimated basis and adjusted based on periodic inventories.

Property and Equipment
Depreciation is provided on a straight-line basis over the estimated useful lives of owned assets. Leasehold improvements and leased properties under capital leases are amortized over the estimated physical life of the property or over the term of the lease, whichever is shorter. Major repairs which extend the useful life of an asset are capitalized in the property and equipment accounts. Routine maintenance and repairs are charged against earnings. The composite method of depreciation is used for equipment; therefore, gains and losses on retirement or other disposition of such assets are included in earnings only when an operating location is closed, completely remodeled or impaired resulting in the carrying amount not being recoverable. Fully depreciated property and equipment are removed from the cost and related accumulated depreciation and amortization accounts.

Property and equipment consists of *(In Millions)*:

	1997	1996
Land and land improvements		
Owned stores	$ 217	$ 102
Distribution centers	19	18
Other locations	9	9
Buildings and building improvements		
Leased stores (building improvements only)	337	321
Owned stores	261	153
Distribution centers	117	108
Other locations	41	38
Equipment		
Stores	783	687
Distribution centers	162	153
Other locations	383	357
Capitalized systems development costs	154	142
Capital lease properties	19	20
	2,502	2,108
Less: accumulated depreciation and amortization	748	659
	$1,754	$1,449

The company capitalizes significant systems development costs. These costs are amortized over a five-year period as phases of these systems are implemented. Unamortized costs as of August 31, 1997 and 1996, were $97 million and $98 million, respectively. Amortization of these costs were $14 million in 1997, and $11 million in both 1996 and 1995.

Income Taxes
The company provides for federal and state income taxes on items included in the Consolidated Statements of Earnings regardless of the period when such taxes are payable. Deferred taxes are recognized for temporary differences between financial and income tax reporting based on enacted tax laws and rates.

Retirement Benefits
The principal retirement plan for employees is the Walgreen Profit-Sharing Retirement Trust, to which both the company and the employees contribute. The company's contribution, which is determined annually at the discretion of the Board of Directors, has historically related to pretax income. The profit-sharing provision was $59 million in 1997, $50 million in 1996 and $44 million in 1995.

The company provides certain health and life insurance benefits for retired employees who meet eligibility requirements, including age and years of service. The costs of these benefits are accrued over the period earned. The company's postretirement benefit plans currently are not funded.

The company has deferred compensation plans which permit directors and certain management employees the right to defer a portion of their compensation. The participants earn interest on deferred amounts depending on various factors defined in the plans. Although not linked to the plans, the company has purchased life insurance on the participants and other key employees to fund the distributions under these and other benefit plans.

Statement of Major Accounting Policies *(Continued)*

Net Earnings Per Common Share

Primary net earnings per share were computed using weighted average number of shares and common share equivalents outstanding of 498,334,545 in 1997, 496,872,010 in 1996 and 495,054,060 in 1995. Fully diluted net earnings per share are the same as primary net earnings per share.

Pre-Opening Expenses

Non-capital expenditures incurred prior to the opening of a new or remodeled store are charged against earnings when they are incurred.

Advertising Costs

Advertising costs are expensed as incurred, and were $68 million in 1997, $82 million in 1996 and $86 million in 1995.

Notes to Consolidated Financial Statements

Interest Expense

The company capitalized less than $1 million of interest expense as part of significant construction projects during fiscal 1997, 1996 and 1995. Interest paid, net of amounts capitalized, was $2 million in 1997 and $3 million in both 1996 and 1995.

Leases

Although some locations are owned, the company generally operates in leased premises. Original non-cancelable lease terms typically are 20 years and may contain escalation clauses, along with options that permit renewals for additional periods. The total amount of the minimum rent is expensed on a straight-line basis over the term of the lease. In addition to minimum fixed rentals, most leases provide for contingent rentals based upon sales.

Minimum rental commitments at August 31, 1997, under all leases having an initial or remaining non-cancelable term of more than one year are shown below *(In Millions)*:

Year	
1998	$ 368
1999	387
2000	370
2001	355
2002	340
Later	3,568
Total minimum lease payments	$5,388

The above minimum lease payments include minimum rental commitments related to capital leases amounting to $11 million at August 31, 1997. The present value of net minimum capital lease payments, due after 1998, are reflected in the accompanying Consolidated Balance Sheets as part of other non-current liabilities. Total minimum lease payments have not been reduced by minimum sublease rentals of approximately $14 million on leases due in the future under non-cancelable subleases.

Rental expense was as follows *(In Millions)*:

	1997	1996	1995
Minimum rentals	$357	$318	$279
Contingent rentals	35	36	35
Less: Sublease rental income	(3)	(3)	(3)
	$389	$351	$311

Income Taxes

The provision for income taxes consists of the following *(In Millions)*:

	1997	1996	1995
Current provision –			
Federal	$228	$196	$177
State	40	36	33
	268	232	210
Deferred provision –			
Federal	7	3	(6)
State	1	–	(1)
	8	3	(7)
	$276	$235	$203

The components of the deferred provision were *(In Millions)*:

	1997	1996	1995
Employee benefit plans	$ (14)	$ (15)	$ (9)
Accelerated depreciation	9	12	10
Insurance	22	1	4
Other	(9)	5	(12)
	$ 8	$ 3	$ (7)

The deferred tax assets and liabilities included in the Consolidated Balance Sheets consist of the following *(In Millions)*:

	1997	1996
Deferred tax assets –		
Employee benefit plans	$ 95	$ 83
Insurance	41	40
Accrued rent	35	28
Inventory	15	15
Other	28	26
	214	192
Deferred tax liabilities –		
Accelerated depreciation	225	253
Inventory	55	33
Other	9	11
	289	297
Net deferred tax liabilities	$ 75	$105

Income taxes paid were $243 million, $241 million and $209 million during the fiscal years ended August 31, 1997, 1996 and 1995, respectively. The difference between the statutory income tax rate and the effective tax rate is principally due to state income tax provisions.

Short-Term Borrowings

At August 31, 1997, the company had approximately $139 million of available bank lines of credit. The credit lines are renewable annually at various dates and provide for loans of varying maturities at the prime rate. There are no compensating balance arrangements.

The company obtained funds through the placement of commercial paper, as follows *(Dollars in Millions)*:

	1997	1996	1995
Average outstanding during the year	$ 8	$ 19	$ 6
Largest month-end balance	42 (Sept)	77 (Nov)	35 (Nov)
Weighted average interest rate	5.4%	5.8%	5.5%

Contingencies

The company is involved in various legal proceedings incidental to the normal course of business. Company management is of the opinion, based upon the advice of General Counsel, that although the outcome of such litigation cannot be forecast with certainty, the final disposition should not have a material adverse effect on the company's consolidated financial position or results of operations.

Capital Stock

All share data have been adjusted to reflect a two-for-one stock split distributed to shareholders August 8, 1997. In addition, the Board of Directors approved increases in the authorized common stock, from 800 million shares to 1.6 billion shares, and in the authorized preferred stock, from 8 million shares to 16 million shares.

In fiscal 1997 there was an additional issuance of 1,507,822 shares causing a $30 million increase in paid-in capital. There were no changes to the company's common stock or paid-in capital balances in fiscal 1996 or 1995.

The company's common stock is subject to a Rights Agreement under which each share has attached to it a Right to purchase one one-hundredth of a share of a new series of Preferred Stock, at a price of $75.00 per Right, in the event a person or group acquires or attempts to acquire 15% of the then outstanding shares of the company. In the event that a person or group acquires 15% or more of the outstanding common stock of the company (other than in certain instances as defined in the Rights Agreement), each Right, except those of an Acquiring Person, would entitle the holder to purchase a number of shares of the company's common stock which number is determined pursuant to a formula contained in the Rights Agreement. The Rights, which are non-voting, will expire on August 21, 2006, but may be redeemed by the company at a price of $.005 per Right at any time prior to a public announcement that 15% or more of the company's common stock has been acquired.

As of August 31, 1997, 62,101,320 shares of common stock were reserved for future stock issuances under the company's employee stock purchase, option and award plans. Preferred stock of 4,937,900 shares have been reserved for issuance upon the exercise of Preferred Share Purchase Rights.

Stock Compensation Plans

The Walgreen Co. Executive Stock Option Plan provides for the granting to key employees of options to purchase company common stock over a 10-year period, at a price not less than the fair market value on the date of the grant. Under this Plan, options may be granted until October 9, 2006, for an aggregate of 19,200,000 shares of common stock of the company. The options granted during fiscal 1997 and 1996 have a three-year holding period.

The Walgreen Co. Stock Purchase/Option Plan (Share Walgreens) provides for the granting of options to purchase company common stock over a period of 10 years to eligible employees upon the purchase of company shares subject to certain restrictions. Under the terms of the Plan, the option price cannot be less than 85% of the fair market value at the date of grant. Compensation expense related to the Plan was less than $1 million in fiscal 1997, 1996 and 1995. Options may be granted under this Plan until September 30, 2002, for an aggregate of 20,000,000 shares of common stock of the company. The options granted during fiscal 1997 and 1996 have a two-year holding period.

A summary of information relative to the company's stock option plans follows:

	Options Outstanding		*Exercisable Options*	
	Shares	*Weighted-Average Exercise Price*	*Shares*	*Weighted-Average Exercise Price*
August 31, 1994	11,311,060	$ 7.93		
Granted	4,229,180	9.43		
Exercised	(463,588)	7.29		
Canceled/Forfeited	(121,032)	9.45		
August 31, 1995	14,955,620	$ 8.36	9,372,342	$7.67
Granted	299,136	12.95		
Exercised	(758,300)	7.69		
Canceled/Forfeited	(42,848)	9.63		
August 31, 1996	14,453,608	$ 8.49	10,741,596	$8.04
Granted	4,706,936	17.97		
Exercised	(2,233,992)	6.26		
Canceled/Forfeited	(143,636)	13.00		
August 31, 1997	16,782,916	$11.40	9,874,942	$8.65

The following table summarizes information concerning currently outstanding and exercisable options:

	Options Outstanding			*Exercisable Options*	
Range of Exercise Prices	*Number Outstanding at 8/31/97*	*Weighted-Average Remaining Contractual Life*	*Weighted-Average Exercise Price*	*Number Exercisable at 8/31/97*	*Weighted-Average Exercise Price*
$ 3 to 5	898,828	1.84 yrs.	$ 4.57	898,828	$4.57
6 to 10	10,905,370	5.57	9.12	8,976,114	9.06
11 to 18	4,978,718	9.06	17.62	–	–
$ 3 to 18	16,782,916	6.41	$11.40	9,874,942	$8.65

Under the Walgreen Co. 1982 Employees Stock Purchase Plan, eligible employees may purchase company stock at 90% of the fair market value at the date of purchase. Employees may purchase shares through cash purchases, loans or payroll deductions up to certain limits. The aggregate number of shares for which all participants have the right to purchase under this Plan is 32,000,000.

The Walgreen Co. Restricted Performance Share Plan provides for the granting of up to 16,000,000 shares of common stock to certain key employees, subject to restrictions as to continuous employment except in the case of death, normal retirement and total and permanent disability. Restrictions generally lapse over a four-year period from the date of grant. Compensation expense is recognized in the year of grant. Compensation expense related to the Plan was $5 million in fiscal 1997, and $4 million in both 1996 and 1995. The number of shares granted was 129,459 in fiscal 1997 and 176,876 in 1996.

The company applies APB Opinion No. 25 and related Interpretations in accounting for its plans. Accordingly, no compensation expense has been recognized based on the fair value of its grants under these plans. Had compensation costs been determined consistent with the method of FASB Statement No. 123 for options granted in 1997 and 1996, pro forma net income for fiscal 1997 and 1996 would have been $423 million and $369 million, respectively, and pro forma earnings per common share for fiscal 1997 and 1996 would have been $.85 and $.74, respectively. The weighted average fair value of options granted at market price during fiscal 1997 and 1996 was $6.65 and $4.72, respectively. The weighted average fair value of options granted below market price during fiscal 1997 and 1996 was $6.95 and $5.11, respectively. The weighted average exercise price of options granted at market price during fiscal 1997 and 1996, was $16.51 and $12.34, respectively. The weighted average exercise price of options granted below market price during fiscal 1997 and 1996, was $18.40 and $13.95, respectively.

The fair value of each option grant used in the pro forma net income and earnings per share was determined using the Black-Scholes option pricing model with weighted-average assumptions used for grants in both fiscal 1997 and 1996:

	1997	1996
Risk-Free Interest Rate	6.29%	5.99%
Average Life of Option (years)	6	6
Volatility	20.00%	19.94%
Dividend Yield	1.07%	1.07%

Postretirement Healthcare Benefits

The service costs and interest cost on the accumulated postretirement healthcare benefit obligation were $4 million and $6 million, respectively, in each of the last three fiscal years.

The company's unfunded accumulated postretirement healthcare benefit liability at August 31, included in the Consolidated Balance Sheets were as follows *(In Millions)*:

	1997	1996
Retirees	$23	$22
Fully eligible active plan participants	12	11
Other active plan participants	54	48
Accumulated postretirement benefit obligation	89	81
Unrecognized actuarial loss	(1)	–
Accrued postretirement benefit liability	$88	$81

The accumulated postretirement healthcare benefit obligation was determined assuming the discount rate was 7.75% and the healthcare cost trend rate was 7.00% for 1997 with a gradual decline over a seven-year period to 5%. These trend rates reflect the company's prior experience and management's expectation that future rates will decline. The effect of a 1% increase each year in the projected healthcare cost trend rate would increase the accumulated postretirement benefit obligation at August 31, 1997 by $17 million and the service and interest cost components of the fiscal 1997 net periodic postretirement benefit cost by $3 million. The unrecognized actuarial amount is being amortized over the average remaining service period of active plan participants.

Supplementary Financial Information

Included in the Consolidated Balance Sheets captions are the following assets and liabilities *(In Millions)*:

	1997	1996
Accounts receivable –		
Accounts receivable	$389	$303
Allowances for doubtful accounts	(13)	(15)
	$376	$288
Accrued expenses and other liabilities –		
Accrued salaries	$164	$137
Taxes other than income taxes	82	74
Profit sharing	92	74
Other	216	182
	$554	$467
Other non-current liabilities –		
Postretirement benefit obligation	$ 85	$ 78
Insurance	72	80
Accrued rent	68	57
Other	57	49
	$282	$264

Report of Independent Public Accountants

To the Board of Directors and Shareholders of Walgreen Co.:

We have audited the accompanying consolidated balance sheets of Walgreen Co. (an Illinois corporation) and Subsidiaries as of August 31, 1997 and 1996, and the related consolidated statements of earnings, retained earnings and cash flows for each of the three years in the period ended August 31, 1997. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Walgreen Co. and Subsidiaries as of August 31, 1997 and 1996, and the results of their operations and their cash flows for each of the three years in the period ended August 31, 1997 in conformity with generally accepted accounting principles.

Arthur Andersen LLP

Chicago, Illinois,
September 26, 1997

Management's Report

The primary responsibility for the integrity and objectivity of the consolidated financial statements and related financial data rests with the management of Walgreen Co. The financial statements were prepared in conformity with generally accepted accounting principles appropriate in the circumstances and included amounts that were based on management's most prudent judgments and estimates relating to matters not concluded by fiscal year-end. Management believes that all material uncertainties have been either appropriately accounted for or disclosed. All other financial information included in this annual report is consistent with the financial statements.

The firm of Arthur Andersen, independent public accountants, was engaged to render a professional opinion on Walgreen Co.'s consolidated financial statements. Their report contains an opinion based on their audit, which was made in accordance with generally accepted auditing standards and procedures, which they believed were sufficient to provide reasonable assurance that the consolidated financial statements, considered in their entirety, are not misleading and do not contain material errors.

Three outside members of the Board of Directors comprise the company's Audit Committee, which meets at least quarterly and is responsible for reviewing and monitoring the company's financial and accounting practices. Arthur Andersen and the company's General Auditor meet alone with the Audit Committee, which also meets with the company's management to discuss financial matters, auditing and internal accounting controls.

The company's systems are designed to provide an effective system of internal accounting controls to obtain reasonable assurance at reasonable cost that assets are safeguarded from material loss or unauthorized use and transactions are executed in accordance with management's authorization and properly recorded. To this end, management maintains an internal control environment which is shaped by established operating policies and procedures, an appropriate division of responsibility at all organizational levels, and a corporate ethics policy which is monitored annually. The company also has an Internal Control Evaluation Committee, comprised primarily of senior management from the Accounting and Auditing Departments, which oversees the evaluation of internal controls on a company-wide basis. Management believes it has appropriately responded to the internal auditors' and independent public accountants' recommendations concerning the company's internal control system.

C. R. Walgreen III
C. R. Walgreen III
Chairman of the Board
and Chief Executive Officer

R. H. Clausen
R. H. Clausen
Controller
and Chief Accounting Officer

R. L. Polark
R. L. Polark
Senior Vice President
and Chief Financial Officer

The Walgreen Year ... A Review by Quarters *(Unaudited)*

Summary of Quarterly Results

(Dollars in Millions, except per share data)

		Quarter Ended				
		November	February	May	August	Fiscal Year
Fiscal 1997	Net sales	$3,054	$3,603	$3,403	$3,303	$13,363
	Gross profit	830	1,006	933	912	3,681
	Net earnings	75	147	108	106	436
	Net earnings per common share	$ .15	$ .30	$ .21	$ .22	$ .88
Fiscal 1996	Net sales	$2,693	$3,179	$2,989	$2,917	$11,778
	Gross profit	739	889	823	812	3,263
	Net earnings	64	126	92	90	372
	Net earnings per common share	$ .13	$ .25	$ .19	$ .18	$ .75

Common Stock Prices

Below are the New York Stock Exchange high and low for each quarter of fiscal 1997 and 1996.

		Quarter Ended				
		November	February	May	August	Fiscal Year
Fiscal 1997	High	$21 7/16	$21 13/16	$ 23 5/8	$ 29 5/8	$ 29 5/8
	Low	16 1/2	19 7/16	20 9/16	23 5/16	16 1/2
Fiscal 1996	High	$ 15 5/8	$ 18 3/16	$17 7/16	$17 7/16	$18 3/16
	Low	12 1/4	14 1/4	15 7/16	15 3/8	12 1/4

Dividends Declared

	Quarter Ended				
	November	February	May	August	Fiscal Year
Fiscal 1997	$ .06	$ .06	$ .06	$ .06	$.24
Fiscal 1996	$.055	$.055	$.055	$.055	$.22

Board of Directors

Directors

Charles R. Walgreen III *
Chairman of the Board and
Chief Executive Officer
Elected 1963

William C. Foote
Chairman of the Board
and Chief Executive Officer,
USG Corporation
Elected 1997

James J. Howard
Chairman of the Board,
Chief Executive Officer and
President,
Northern States Power Company
Elected 1986

Charles D. Hunter
Former Vice Chairman and
Chief Financial Officer
Elected 1974

L. Daniel Jorndt *
President and Chief
Operating Officer
Elected 1990

Cordell Reed
Former Senior Vice President,
Commonwealth Edison Co.
Elected 1994

John B. Schwemm
Former Chairman and
Chief Executive Officer,
R.R. Donnelley & Sons Co.
Elected 1985

William H. Springer
Former Vice Chairman,
Ameritech Corporation
Elected 1988

Marilou M. von Ferstel
Former Executive Vice President
and General Manager,
Ogilvy Adams & Rinehart
Elected 1987

Committees

Executive Committee
Charles R. Walgreen III,
Chairman
Charles D. Hunter
L. Daniel Jorndt
John B. Schwemm
William H. Springer

Audit Committee
John B. Schwemm,
Chairman
William C. Foote
Marilou M. von Ferstel

Compensation Committee
William H. Springer,
Chairman
James J. Howard
John B. Schwemm

Finance Committee
Charles D. Hunter,
Chairman
L. Daniel Jorndt
Cordell Reed
Charles R. Walgreen III

Nominating and Governance Committee
John B. Schwemm,
Chairman
James J. Howard
Marilou M. von Ferstel

**In January, Mr. Walgreen will retire as Chief Executive Officer. Mr. Jorndt will assume the CEO position.*

Officers

Corporate

Chairman
Charles R. Walgreen III*
Chief Executive Officer

President
L. Daniel Jorndt*
Chief Operating Officer

Executive Vice Presidents
Vernon A. Brunner
Marketing
Glenn S. Kraiss
Store Operations

Senior Vice Presidents
David W. Bernauer
Chief Information Officer
Roger L. Polark
Chief Financial Officer
John A. Rubino
Human Resources
William A. Shiel
Facilities Development

Vice Presidents
Robert C. Atlas
Eastern Store Operations
W. Lynn Earnest
Central Store Operations
Robert H. Halaska
President,
WHP Health Initiatives
Jerome B. Karlin
Western Store Operations
J. Randolph Lewis
Distribution & Logistics
Julian A. Oettinger
General Counsel,
Corporate Secretary

Regional Vice Presidents Drug Store Division

Enrique F. Anglade
R. Bruce Bryant
George C. Eilers
Patrick E. Hanifen
Barry L. Markl
Robert G. McKillop
Richard J. McMillin
Richard L. Moyer
Richard Robinson
Bill J. Vernon
Kevin P. Walgreen
Edward E. Williams
Bruce C. Zarkowsky

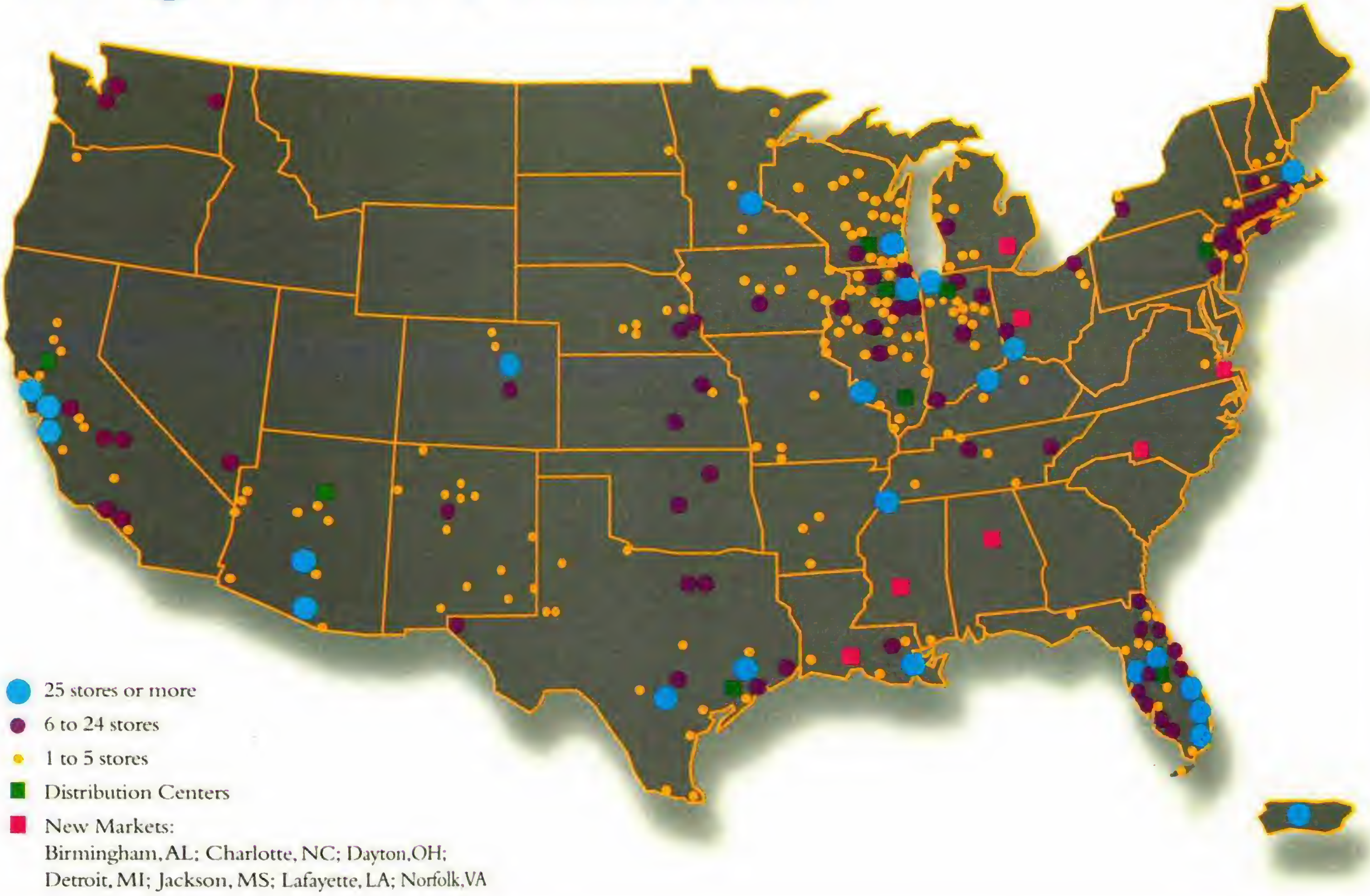
Divisional Vice Presidents

Roger H. Clausen
Controller
John W. Gleeson
Marketing Systems
and Services
Don R. Holman
Purchasing/Merchandising
Joel H. Levin
Tax
Dennis R. O'Dell
Health Services
Mark R. Paul
Purchasing/Merchandising
Jeffrey A. Rein
Treasurer
Craig M. Sinclair
Corporate Advertising
Chester G. Young
General Auditor

Assistant Secretaries
Nancy J. Godfrey
Dana I. Green
Edward H. King
Joel H. Levin
Allan M. Resnick

Assistant Treasurers
Robert E. Kahng
John M. Palizza

Walgreens Nationwide



State	1997	1996
Arizona	134	128
Arkansas	9	8
California	168	139
Colorado	53	49
Connecticut	32	32
Florida	395	370
Illinois	330	318
Indiana	100	103
Iowa	31	30
Kansas	17	15
Kentucky	39	36
Louisiana	49	48
Massachusetts	72	71
Michigan	28	26
Minnesota	62	61
Mississippi	5	5
Missouri	75	71
Nebraska	29	29
Nevada	11	2
New Hampshire	9	8
New Jersey	38	37
New Mexico	37	36
New York	30	26
North Dakota	1	1
Ohio	61	56
Oklahoma	22	19
Oregon	5	1
Pennsylvania	5	2
Rhode Island	12	7
Tennessee	81	76
Texas	234	213
Virginia	5	2
Washington	19	12
Wisconsin	115	114
Puerto Rico	45	42
Total	**2,358**	**2,193**

Information is provided as of fiscal year-end.

Drugstore Unit and Sales Overview

	Fiscal Year	1997	1996	1995	1994	1993
Drugstore Units	Openings					
	New Stores	247	205	202	194	149
	Acquisitions	4	5	4	2	0
	Remodelings	46	71	84	70	138
	Closings	86	102	89	64	49
	Year End: Units *(1)*	2,358	2,193	2,085	1,968	1,836
	Year End: Sales Area *(2)*	23,935	22,124	20,731	19,342	17,950
Product Class Sales	Prescription Drugs	47%	45%	43%	41%	38%
	Nonprescription Drugs *(3)*	13	13	13	13	14
	Cosmetics, Toiletries *(3)*	8	8	8	9	9
	General Merchandise *(3)*	23	24	24	24	25
	Tobacco Products *(3)*	3	3	4	4	4
	Liquor, Beverages	6	7	8	9	10

(1) Includes 41 pharmacy-only units and two mail service facilities.
(2) In thousands of square feet.
(3) Estimates based, in part, on store scanning information.

Shareholder Information

Corporate Headquarters
Walgreen Co.
200 Wilmot Road
Deerfield, Illinois 60015
(847) 940-2500

Shareholder Communications
Please address inquiries or comments to:
Shareholder Relations
Walgreen Co. – Mail Stop #2261
200 Wilmot Road
Deerfield, Illinois 60015
(847) 914-2972

The company's annual report to the Securities and Exchange Commission, Form 10-K, may be obtained by any shareholder, free of charge, upon written request.

Quarterly Reports
Quarterly earnings release dates for 1998 are January 5, March 30, June 29 and October 5. Results are released to the press and posted on Walgreens internet home page. Quarterly reports are also mailed to shareholders on request. **This mailing list is being updated in January 1998.** To receive the quarterly reports, please return the card in this year's Annual Report before January 1, 1998. Please note that if we do *not* hear from you, your name will be deleted from the quarterly list. You may also request reports at any time by contacting Shareholder Relations, (847) 914-2972.

Internet Address
Major press releases and other information are available on Walgreens internet home page: *http://www.walgreens.com*

Transfer Agent and Registrar
Harris Trust and Savings Bank
Shareholder Services
311 West Monroe Street, 11th Floor
Chicago, Illinois 60690
(888) 368-7346

Annual Shareholders' Meeting
You are cordially invited to attend the meeting to be held Wednesday, January 14, 1998, 2 p.m. in the Arthur Rubloff Auditorium, The Art Institute, Chicago, Illinois.

Formal notice of the meeting, with proxy card and proxy statement, was mailed to all shareholders of record as of November 17, 1997.

Stock Market Listings
New York Stock Exchange
Chicago Stock Exchange
Symbol: WAG

Investor Contacts
John M. Palizza
Jeffrey A. Rein

Dividend Payment Dates
Walgreens pays dividends in March, June, September and December. Checks are customarily mailed on approximately the 12th of each of these months.

Direct Stock Purchase Plan
(Replaced Walgreens Dividend Reinvestment Plan in September 1997)
Harris Trust and Savings Bank is sponsoring and administering a direct stock purchase plan called Harris DOCS as a convenient method of acquiring additional Walgreen stock by reinvestment of dividends, optional cash payments, or both. For an information booklet and enrollment form, please call (800) 286-9178. General inquiries to Harris regarding your Walgreen stock should be directed to (888) 368-7346.

Printed on Recycled Paper

Walgreens

Walgreen Co.
200 Wilmot Road
Deerfield, Illinois 60015
www.walgreens.com